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No. 97-_____

In the

Supreme Court of the United States

October Term, 1997

Kevin Miller, Wesley C. Hayne and E. Chris Farni,
Petitioners,

v.

Dr. Charles W. Flume, *et al.*,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether it violates the due process rights of an employee of a NASD-registered broker/dealer if the employee is compelled to forgo a jury trial and instead arbitrate claims asserted by a former customer of the firm, when the claims are based on conduct that occurred after the customer relationship with the firm ended and where there never was any customer relationship between the parties.

RULE 29 STATEMENT
PARTIES TO THE PROCEEDING

The petitioners are Kevin Miller; Wesley C. Hayne; and E. Chris Farni.

The respondents are Dr. Charles W. Flume; Nancy Flume; Charles W. Flume, D.D.S., S.C., Defined Benefit Plan; and Charles W. Flume, D.D.S., S.C., a Wisconsin professional corporation.

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Petitioners Kevin Miller, Wesley C. Hayne and E. Chris Farni seek a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit is reported at 139 F.3d 1130 (1998). (A-1-A-15.) The opinion of the United States District Court for the Eastern District of Wisconsin, which the Seventh Circuit reversed, is unreported. (A-16-A-29.)

JURISDICTION

The Seventh Circuit Court of Appeals issued its decision and entered judgment on March 24, 1998.

Petitioners invoke the jurisdiction of this Court under 28 U.S.C. §1254(1) (1994).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

"No person shall . . . be deprived of life, liberty, or property without due process of law;" U.S. CONST., amend. V.

"In suits at common law, . . . , the right of trial by jury shall be preserved, ..." U.S. CONST., amend. VII.

9 U.S.C. § § 2 (1994)

§ 2. Validity, irrevocability, and enforcement of agreements to arbitrate.

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3 (1994)

§ 3 Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

STATEMENT OF THE CASE

Petitioners are former directors, officers or shareholders of Hayne, Miller & Farni, Inc. (HMF), a New York corporation that operated as a broker/dealer in Minneapolis, Minnesota. (A-18.) Respondents, collectively called the Flumes, include Dr. Charles W. Flume, a dentist practicing in La Crosse, Wisconsin, his professional corporation and his defined benefit plan (Plan). (A-30-A-31.)

In February 1988, Dr. Flume began using James Peterson, who then worked at the brokerage firm of Heiner & Stock, to handle the Plan's investments. (Appellees' App. 103.)[1] In May 1990, Peterson began working for HMF and took the Flume account with him. (Appellees' App. 103.) Peterson was the Flumes' sole contact with HMF and they traded directly through him. (Appellees' App. 103-04.) The Flumes stopped trading with HMF in September 1992 and no longer maintained an account with the firm after they started their arbitration proceeding against HMF. (Appellees' App. 65-66, 106.)

HMF was a member of the National Association of Securities Dealers (NASD). The NASD is a self-regulating securities association established pursuant to 15 U.S.C. § 78o-3. The NASD has established its own Code of Arbitration Procedure, and its arbitration rules are subject to the approval of the Securities and Exchange Commission under 15 U.S.C. § 78s(b)(1) and 17 C.F.R. § 19b-4.

In its procedural code, the NASD establishes which disputes are eligible for NASD arbitration:

> Section 1. This Code of Arbitration Procedure is prescribed and adopted pursuant to Article VII,

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[1] References to Appellants' or Appellees's Appendix are to the appendices the parties filed in the Seventh Circuit.

> § 1(a)(3) of the bylaws of the National Association of Securities Dealers, Inc., (the Association) for the arbitration of any dispute, claim or controversy arising out of or in connection with the business of any member of the Association, with the exception of disputes involving the insurance business of any member which is also an insurance company:
>
> (a)between or among members;
>
> (b)between or among members and public customers, or others;
>
> (c)between or among members or associated persons and public customers, or others . . .

National Association of Securities Dealers, A CODE OF ARBITRATION PROCEDURE § 1 (1993); NASD MANUAL (CCH), *Code of Arbitration Procedure* Rule 10101 (1997) (emphasis added).

In addition, section 12(a) of the NASD Code of Arbitration defines disputes that are "required to be arbitrated":

> Sec. 12.(a). Any dispute, claim or controversy eligible for submission under Part I of this Code between a customer and a member and/or associated person arising in connection with the business of such member or in connection with the activities of such associated persons shall be arbitrated under this Code, as provided by any duly executed and enforceable written agreement or upon the demand of the customer.

Id. § 12(a); NASD MANUAL (CCH), *Code of Arbitration Procedure* Rule 10301 (1997) (emphasis added).

In June 1993, the Flumes initiated a NASD arbitration proceeding against HMF and Peterson in which the Flumes asserted various securities and common law claims against HMF and sought over $300,000 in damages. (A-31, Appellees' App. 130.) The Flumes claimed that Peterson had engaged in unsuitable trading activity for the Plan and had caused the Plan to incur losses when his trading activity caused the Plan to incur an overdraft in its bank account. *Hayne, Miller & Farni, Inc. v. Flume*, 888 F. Supp. 949, 951 (E.D. Wis. 1995). According to the Flumes, HMF failed adequately to supervise Peterson's trading activities for the Plan. The Flumes did *not* name petitioners in their arbitration claim, after concluding that they had no basis for asserting that petitioners were personally liable for Peterson's misconduct. (Appellees' App. 75-76.)

The matter went to arbitration under NASD uniform submission agreements HMF and the Flumes had signed consenting to arbitration under § 12 of the NASD Code of Arbitration. Following a five-day evidentiary hearing in March 1994, an NASD arbitration panel found partially for the Flumes and awarded them $150,000 in damages and costs of $28,034.40. (A-3.)[2] In May 1995, over HMF's objection, the district court confirmed the arbitrators' award and entered judgment in the amount of $178,034.40 plus interest. (A-3.)

HMF never paid that judgment, though it made a substantial settlement offer that the Flumes rejected. (Appellee's App. 222.) In November 1994, during the pendency of its appeal of the arbitration award, HMF ceased business, surrendering its NASD license effective January 23, 1995. (A-3; Appellees' App. 184.) Farni and Hayne left

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[2] The panel made no award against Peterson, who had filed for bankruptcy during the proceeding. (A-3.)

HMF during the same time period, March and July 1994, respectively. (Appellees' App. 173-74.)

In October 1995 respondents filed a new NASD arbitration action against petitioners in their individual capacities. (A-30-A-38.). Essentially, the Flumes assert in their new claims that petitioners, as former principals or control persons of HMF, engaged in fraudulent transfers of the assets of HMF to avoid having to pay respondents' judgment. (A-2.) What the Flumes claimed was that in 1993 HMF paid $450,000 in management fees and transferred stock worth $1,175,000 to its parent holding company. (A-33.)

The Flumes have failed to mention, however, that in fact in 1993 the parent holding company infused $638,281 in capital into HMF and waived $150,000 in management fees. Because HMF also earned a net profit of $485,904 during 1993, HMF's net capital increased overall. (Appellees' App. 222-23.) In addition, the parent company infused $1,100,000 in capital into HMF in 1994. (Appellees' App. 223.) The net effect was that the parent holding company put more assets into HMF than were transferred out. Unfortunately, HMF's capital consisted primarily of common stock that declined dramatically in value in 1994. Faced with strict NASD net capital requirements, HMF went out of business. (Appellees' App. 184.) Other creditors besides the Flumes were left unpaid. (Appellees' App. 158.)

The Flumes did not try to enforce their judgment or proceeding under the fraudulent conveyance statutes of either Minnesota or Wisconsin.[3] Despite having deliberately decided not to pursue petitioners individually in 1993, the Flumes instead elected to bring a second NASD arbitration proceeding against petitioners to recoup their losses. Petitioners did not consent to this effort to arbitrate by signing

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[3] Both states have adopted the Uniform Fraudulent Transfer Act. *See* Minn. Stat. § 513.41 *et seq.* (1996) and Wis Stat. § 242.01 *et seq.* (1996).

a NASD uniform arbitration agreement. Petitioners had, however, signed a NASD Form U-4 on becoming registered with the NASD as broker/dealers. (A-17-A-18.) Form U-4 provides in part:

> I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or bylaws of the organizations with which I register, as indicated in item 10 as may be amended from time to time.

(A-4) (emphasis added). By signing the Form U-4, the petitioners consented to arbitrate only those disputes that are required to be arbitrated under the NASD's Code of Arbitration. It is this form that the Flumes are trying to use to preclude petitioners from seeking a judicial forum to resolve respondents' new claims.

Petitioners filed for a declaratory judgment seeking a declaration that they had not consented to arbitrate this second set of claims. The district court granted petitioners' motion for a preliminary injunction. The district court determined that the court, not the arbitrators, should determine the threshold issue of arbitratability. (A-20.) The district court went on to hold that the Flume' claims were not arbitrable because they were not customers within the meaning of § 12(a) of the NASD Code of Arbitration Procedure. In reaching this holding, the district court relied on *Wheat, First Securities, Inc. v. Green*, 993 F.2d 814 (11th Cir. 1993) and *Gruntal & Co. v. Steinberg*, 854 F. Supp. 324 (D.N.J.), *aff'd*, 46 F.3d 1116 (3d Cir. 1994)(table), to conclude that the determination of whether one is customer must be based on when the underlying acts occurred. The district court then looked to *Armada Coal Export, Inc. v. Interbulk Ltd.*, 726 F.2d 1566 (11th Cir. 1984) to conclude that the Flumes'

second set of claims lacked sufficient nexus to the business of HMF to arise "in connection with" a securities transaction. (A-26.)

The Seventh Circuit, while agreeing with the district court on the threshold question of which tribunal should decide arbitratability, reversed on the question whether respondents' claims had to be arbitrated. (A-2, A-13.) The court of appeals found that respondents were customers under § 12(a) of the NASD Code of Arbitration Procedures because the initial fraudulent activities took place when the Flumes were customers of HMF. The court below distinguished *Wheat* and *Gruntal* on the ground that in those two cases the underlying acts took place before the investors became customers of the NASD registered firms. (A-11-A-12.) Additionally, the court noted that NASD members, and by extension, their employees, were required to honor arbitration awards. (A-13.) The court then read the relevant arbitration clause very broadly to hold that the alleged fraudulent conveyances to have arisen out of NASD-authorized business. (A-14.)

REASONS FOR GRANTING THE WRIT

This Court should grant this petition for certiorari for two reasons. The Seventh Circuit "has entered a decision in conflict with the decision of [the Eleventh Circuit] on the same important matter." SUP. CT. R. 10(a). The NASD requires that certain matters under its purview be arbitrated "between or among members or associated persons and public customers. . . ." NASD CODE OF ARB. PROC. § 1(c). In *Wheat, First Sec. v. Green*, 993 F.2d 814 (11th Cir. 1993), the Eleventh Circuit held that "customer status for the purposes of the 'customer' requirement of [the] NASD . . . must be determined as of the time of the events providing the basis for the allegations of fraud." *Id.* at 820. In the present case, the

Seventh Circuit held, in direct conflict with *Wheat*, that one could be a "customer" of an NASD member or associated person as long as events providing the basis for the fraud allegations loosely "ar[o]se out of th[e] direct customer-broker relationship," regardless of whether those events occurred subsequent to the termination of that relationship. (A-12.)

In addition, the Seventh Circuit "has decided an important question of federal law that has not been, but should be, settled by this Court. . . ." SUP. CT. R. 10(c). Although this Court has considered the permissibility of arbitration clauses in the securities industry generally, *see Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), the Court has not construed the meaning of the term "customer" in the NASD Code of Arbitration. Who is considered a customer for purposes of the Code is an important question, as this determination acts as a jurisdictional gatekeeper for actions brought under the Code. Employees of NASD registered firm may be required to arbitrate claims with their customers, but they have not consented to and should not be required to arbitrate claims that arise outside the period when the claimant was a customer. The flaw in the decision below is to fail to read such consent to arbitrate in light of the right of an employee of a NASD firm to a jury trial and the procedural protections afforded the judicial process.

I. TWO UNITED STATES COURTS OF APPEAL ARE IN CONFLICT OVER THE INTERPRETATION OF A KEY TERM OF THE NASD CODE OF ARBITRATION

The federal policy favoring arbitration is premised on the consent of the parties. As this Court has stated, "arbitration is

a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *Airline Pilots' Ass'n v. Miller*, ___ U.S. ___, 118 S. Ct. 1761, 1767 (1998) (quoting *United Steelworkers v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 582 (1960)). When becoming an NASD-registered broker, petitioners agreed to arbitrate any dispute that NASD rules *required* to be arbitrated. Under the NASD Code of Arbitration, the only disputes that are required to be arbitrated are those disputes brought by customers that arise in connection with the member's business, *i.e.*, securities trading. And with respect to petitioners, any consent to arbitrate was further limited to events that took place during their employment with HMF. Whether petitioners ever consented to arbitrate with the Flumes thus depends on whether their claims arise out of acts that took place while the Flumes were customers of HMF and petitioners were employees of HMF.

The undisputed facts here show that the Flumes ceased trading with HMF in September 1992. Petitioner's consent to arbitrate thus ended when the Flumes stopped trading with HMF, because that is when the customer relationship ended. Any doubt that the Flumes' customer relationship had ended then was resolved when they initiated their first arbitration proceeding. Indeed, when the Flumes started their arbitration proceeding, they did not see fit to name petitioners, who could then reasonably assume that was the end of the matter for them individually.

The Seventh Circuit ruled otherwise, and in doing so, defined the customer relationship in a manner that conflicts directly with the approach used by the Eleventh Circuit. In *Wheat*, the Eleventh Circuit held that "customer status for the purposes of the customer requirement of [the] NASD . . . must be determined as of the time of the events providing the basis for the allegations of fraud." 993 F.2d at 820. In that case, the appellants were investors who held securities

trading accounts with Marshall Securities, a brokerage firm. *Id.* at 815. After the allegedly fraudulent act took place, the appellee, also a brokerage firm, purchased some of the trading accounts of Marshall. *Id.* at 816. To compel the appellee to arbitrate, the appellants argued that, because the appellee purchased some of Marshall's trading accounts, the appellants were "customers" of the appellee. *Id.* at 820. The Eleventh Circuit rejected this contention, reasoning that:

> we cannot imagine that any NASD member would have contemplated that its NASD membership alone would require it to arbitrate claims which arose while a claimant was a customer of another member merely because the claimant subsequently became its customer. The potential for abuse under this scheme is manifestly apparent . . . We therefore hold that customer status for the purposes of the "customer" requirement of [the] NASD . . . must be determined as of the time of the events providing the basis for the allegations of fraud. The Appellants were not customers of [the appellee] at the time of the allegedly fraudulent . . . stock transactions. Thus, they cannot invoke the NASD Code to compel [the appellee] to arbitrate.

Id.

The Seventh Circuit in the present case used a different conceptual approach to the term customer to come to the opposite conclusion. It is undisputed that the Flumes stopped trading with HMF in September 1992 and terminated the relationship in June 1993. It is also undisputed that the allegedly fraudulent transactions occurred after the customer relationship ended. (A-23.) Nevertheless, the Seventh Circuit held that the respondents were customers of the petitioners.

(A-11-A-12.) The rationale for its holding evinces a different standard:

> The judgment debt [the respondents] are trying to collect is one that ran from HMF to them as the firm's customers. None of the risks of remote liability that motivated the *Wheat* court exist here. [The petitioners] are not being asked to assume responsibility for the actions of stranger firms with whom they are linked only by an asset purchase. Instead, these persons associated with HMF will be potentially liable only to individuals who were customers of the firm while it was in operation, and only for actions that arose out of or were connected with the firm's business.

(A-12.)

Although the Seventh Circuit attempted to distinguish the Eleventh Circuit holding in *Wheat*, on functionally similar facts these two courts have reached different conclusions regarding definition of "customer" in the NASD Code of Arbitration. Under the analysis employed by the Eleventh Circuit, customer status must be determined "as of the time of the events providing the basis for the allegations of fraud." *Wheat*, 993 F.2d at 820. In contrast, the Seventh Circuit ignored the fact that the Flumes were no longer customers of HMF when the allegedly wrongful conveyance occurred and instead rested its decision on whether the allegedly fraudulent actions "arose out of or were connected with the firm's business." (A-12.) While the Seventh Circuit claimed that none of the risks of remote liability that motivated the *Wheat* court exist in this case, and that this fact distinguished the two cases, this purported distinction missed the point. The *Wheat* court was concerned not only with remote liability, but also with the more fundamental concern of requiring someone to

arbitrate when that person had not agreed to do so. 993 F.2d at 820.

The facts of the present case clarify the distinction. The business relationship ended between the parties in September 1992. The allegedly fraudulent transactions occurred in 1993, months or years *after* the end of the relationship. Under *Wheat*, customer status would be determined at the former date–*after* the business relationship ended. 993 F.2d at 820. Accordingly, under *Wheat*, the respondents would not be customers under the NASD Code and would not be able to initiate arbitration proceedings. In contrast, under the Seventh Circuit's analysis, because the allegedly fraudulent actions "arose out of or were connected with the firm's business," an incredibly broad standard, the respondents would be construed as customers for purposes of the NASD Code. Moreover, the risk of remote liability, the distinguishing point the court below relied on, exists here. When the Flumes did not name petitioners individually in 1993 in the first arbitration proceedings, petitioners were entitled to assume that their individual obligations to arbitrate disputes with Flumes ended. Certainly, petitioners never gave their consent to arbitrate claims based on events occurring after the customer relationship ended and even after some of them had left HMF.[4] Thus, there is a clear split between the circuits

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[4] It is also incorrect to suggest, as the court below did (A-13), that the NASD requirement that members should honor arbitration awards is a basis for concluding that the Flumes' second set of claims arose out of the acts underlying the first arbitration. Nothing in the NASD rule makes a failure to pay an arbitration award subject to a second arbitration, for there is no reason to conclude that a second arbitration award would be any more likely to be paid. Failure to pay an arbitration award is simply grounds for NASD discipline. *See* NASD MANUAL (CCH) Rule 9211(a); *Stephen Inv. Securities, Inc. v. SEC*, 27 F.3d 339, 341-42 (8th Cir. 1994) (affirming NASD-imposed sanction for failing to pay arbitration award). Once a court confirms an arbitration award, it is judicially enforceable. Thus, enforcement of the award must lie through the judicial process, not

regarding the jurisdictional matter of when one is a "customer" under the NASD Code of Arbitration.

II. THE SEVENTH CIRCUIT HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW THAT HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT

This Court has not considered the important question of who is a "customer" for purposes of the NASD Code of Arbitration. The ramifications of such a determination are great. This determination will help delineate the jurisdictional parameters of who can invoke the arbitration clause under the NASD. Potential complainants who seek to hamstring securities firms and their officers by invoking the NASD arbitration procedure to resolve disputes that arise *after* the termination of the business relationship will be prevented from doing so.

The question of who is a customer under the NASD Code is also important because the determination affects the constitutional right to due process. All petitioners consented to was to arbitrate claims that arose when a customer relationship existed. As one court has put it, "[d]ue process requires that all conflicts over legal rights and obligations be adjudicated in a court of law. Arbitration is an exception to this rule *but it is an exception grounded on the parties' consent.* Without consent, arbitration lacks the power to bind either the parties or a court of law in a subsequent proceeding." *United States ex rel. Pensacola Constr. Co. v. St. Paul Fire and Marine Ins. Co.*, 705 F. Supp. 306, 314 (W.D. La. 1988) (citing *United Steelworkers of Am. v. Enterprise Wheel and Carriage Corp.*, 363 U.S. 593, 597

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by trying to hold individual employees of an NASD-registered firm liable for the firm's failure to pay the award.

(1960); *Davis v. Chevy Chase Fin. Ltd.*, 667 F.2d 160, 165 (D.C. Cir. 1981); and RESTATEMENT (SECOND) OF JUDGMENTS § 84 cmt. d (1984) (emphasis added)).

It is undisputed that none of the petitioners had a client relationship with the Flumes. The Flumes never bought or sold securities through petitioners. Rather, the Flumes dealt only with James Peterson, who started trading for the Flumes while at another brokerage firm. Consequently, the Flumes were never a direct customer of these three individuals nor did they ever consent to have claims arbitrated with the Flumes for acts occurring well after the customer relationship ended.

Arbitration without consent is a denial of due process. Allowing *former* customers of NASD members or associated persons to sue those individuals is an unwarranted extension of the NASD Code of Arbitration, as the plain language of the Code only requires arbitration between NASD members or associated persons and their "customers." In interpreting contracts, "words are to be given their plain and ordinary meanings." *Timber Access Indus. Co., Inc. v. United States*, 213 Ct. Cl. 648, 553 F.2d 1250,1256 (1977). The plain meaning of the term "customer" encompasses one "who *makes* purchases of, or *has* business dealings with, a tradesman or business." BLACK'S LAW DICTIONARY 348 (5th ed. 1979) (emphasis added). The Flumes never bought or sold securities with petitioners, only with James Peterson and HMF. In addition, if the NASD intended to include within its Code of Arbitration Procedure former customers as those who could require arbitration of NASD members or their employees, it would have specifically provided for this. *See, e.g., Gozlon-Peretz v. United States*, 498 U.S. 395, 404 (1991); *Longview Fibre Co. v. Rasmussen*, 980 F.2d 1307, 1312-13 (9th Cir. 1992) ("[T]he *expressio unius*, or *inclusio unius*, principle is that `[w]hen a statute limits a thing to be done in a particular mode, it includes a negative of any other

mode'") (quoting *Raleigh & Gaston Ry. Co. v. Reid*, 80 U.S. (13 Wall.) 269, 270 (1871)).

The Seventh Circuit's decision pits its desire for an all-encompassing arbitration clause against the constitutional right to due process. It allows anyone to invoke arbitration–customer or former customer–as long as the allegation promulgated by the claimant "arose out of or were connected with the firm's business." (A-12.) In other words, an individual who was a customer of an NASD member or associated person years before can still invoke the NASD arbitration clause as long as his allegation falls anywhere within the Seventh Circuit's "black hole" standard. This is a denial of due process, as it forecloses the NASD member or associated person's opportunity to be heard in court regarding matters outside of the reach of the NASD arbitration code.

CONCLUSION

For the foregoing reasons, petitioners request that the Court grant their petition for a writ of certiorari to review the decision of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

Dated: June 22, 1998.

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 97-1127

Kevin MILLER, et al.,

Plaintiffs-Appellees,

v.

Dr. Charles W. FLUME, et al.,

Defendants-Appellants.

Appeal from the United States District Court
for the Eastern District of Wisconsin.
Patricia J. Gorence, *Magistrate Judge*
No. 96-CV-0029

ARGUED JUNE 3, 1997–DECIDED MARCH 24, 1998

Before CUMMINGS, HARLINGTON WOOD, JR., and DIANE P. WOOD, *Circuit Judges.*

DIANE P. WOOD, *Circuit Judge.*

This is a somewhat unusual case raising questions about the court's authority to decide whether a particular dispute is arbitrable, as well as the merits of a district court decision refusing to stay proceedings for an arbitration. Its atypical

character arises from the fact that the parties before us—Dr. Charles W. Flume and others associated with him, on the one hand, and securities brokers Kevin Miller, Wesley C. Hayne, and E. Chris Farni (to whom we refer as "the brokers"), on the other—have already arbitrated the Flumes' claim against the brokerage firm with which Miller and his colleagues were affiliated, the arbitral panel has rendered a final award, and the district court has confirmed the award. See *Hayne, Miller & Farni, Inc. v. Flume*, 888 F.Supp. 949 (E.D.Wis.1995) (*Flume I*). The Flumes commenced the arbitration that is the subject of the present appeal when the firm dissolved and, they claim, its officers fraudulently transferred the firm's assets to avoid paying the arbitral award in the Flumes' favor of some $178,034 plus interest. The brokers promptly repaired to federal court to enjoin the second arbitral proceeding, and in a proceeding held by consent before the magistrate judge, the court obliged them. The Flumes appealed from the injunction under 9 U.S.C. § 16(a)(2). As we explain below, the district court erred in enjoining the arbitration; we therefore reverse.

I.

At this stage, the underlying dispute between the parties is of little relevance, although those who are interested may find a description of it in the district court's opinion confirming the first arbitral award. *Flume I*, 888 F.Supp. at 951. In brief, the appellants (to whom we refer collectively as the Flumes) are Dr. Charles W. Flume, his wife Nancy Flume, Dr. Flume's professional corporation, and the benefit plan it established under the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001 et seq. From May 1990 until approximately 1992 or 1993, the Flumes had an account with broker-dealer Hayne, Miller & Farni, Inc. (HMF), a member firm of the National Association of Securities Dealers (NASD). The broker-appellees, Hayne, Miller, and Farni,

were officers and directors of HMF. In June 1993, the Flumes began an arbitration under the rules of the NASD against their HMF broker (James D. Peterson) and against HMF itself, in which they alleged violations of ERISA, state and federal securities fraud, common law fraud, breach of fiduciary duty, and negligence. On March 15, 1994, the NASD panel found HMF liable to the Flumes and awarded them $150,000 in damages and $28,034.40 in costs. (It awarded nothing against Peterson, who had filed for bankruptcy during the arbitration.) HMF then filed an action with the district court for the Eastern District of Wisconsin for vacatur of the award, and the Flumes responded with a counterclaim asking for confirmation of the award. On May 24, 1995, the district court denied HMF's motion and granted the Flumes' request for confirmation, entering a judgment for the total amount due of $178,034 plus interest. *Flume I*, 888 F.Supp at 955. The Flumes then learned that HMF had ceased operations while the motion for vacatur was pending in the district court. To this day, HMF has not paid any part of the judgment; instead, on December 31, 1994, it filed for withdrawal of its broker/dealer license with the NASD, which granted the request effective January 23, 1995.

The Flumes subsequently learned that while the arbitration and HMF's appeal were pending, the broker-appellees had transferred assets away from HMF. They claim that in 1993, HMF transferred investment securities with an approximate market value of $1,175,000 at the date of transfer to its parent company HMF Holdings, Inc., and recorded the transaction as a reduction of additional paid-in capital. They also claim that HMF paid its parent another $450,000 in "management fees" over the same time period, which brought the total outflow up to about $1,625,000. Later, in November 1994 (again while HMF's vacatur action in the district court was pending), the Flumes claim that broker Miller transferred other valuable assets of HMF, including its customer accounts and retail

brokerage force, to a new brokerage firm, Miller Financial Group, which Miller controlled. That firm continues to operate, they allege, and to reap the benefit of the assets transferred from HMF.

Frustrated that HMF had not satisfied the arbitral award against it, and with this new information in hand, the Flumes initiated a second NASD arbitration. This claim, filed in October 1995, alleged that Hayne, Miller, and Farni were "former principals and control persons" of HMF. It went on to claim that they had participated in the fraudulent acts that HMF had perpetrated on the public, and that they had failed to discharge their legal duty to supervise properly HMF's representatives, including broker Peterson. It also described the alleged fraudulent transfers about which they had learned, and claimed that the brokers had taken these actions to avoid paying the arbitral award in favor of the Flumes. All of these actions, they alleged, violated various rules of the NASD, and for that reason they claimed the right to bring the second arbitration under the NASD's rules.

When the Flumes began the second arbitration, they signed a "Uniform Submission Agreement," which is a form prescribed by the NASD. The brokers had each signed NASD Form U-4, which is a registration document that the NASD requires brokers to execute when they become registered NASD broker-dealers. Paragraph 5 of Form U-4 reads as follows:

> 5. I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or bylaws of the organizations with which I register, as indicated in item 10 as may be amended from time to time.

The pertinent organization referred to in item 10 for these brokers is the NASD itself. Upon receiving the Flumes' second Statement of Claim, the NASD served it upon the brokers with a cover letter stating that "[t]he Statement of Claim is being sent to you because you also signed an agreement to arbitrate disputes involving yourself and claimant." Its letter indicated that the place of the arbitration would be Milwaukee, Wisconsin; the initial hearing was later scheduled for March 26 and 27, 1996.

The brokers did not welcome the prospect of a second arbitration. They turned instead to the federal court, filing the present lawsuit on January 8, 1996. Their complaint sought a declaration that the brokers were not required to arbitrate with the Flumes, and a preliminary and permanent injunction barring the Flumes from pursuing their new NASD arbitration. After a hearing by consent on October 4, 1996 before a magistrate judge, see 28 U.S.C. § 636(c)(1), the district court granted the brokers' motion for a preliminary injunction. *Miller v. Flume*, No. 96-C0029, memorandum and order at 11 (E.D.Wis. Dec. 26, 1996) (*Flume II*). Relying on this court's decision in *Edward D. Jones & Co. v. Sorrells*, 957 F.2d 509, 514 n. 6 (7th Cir.1992), the court first ruled that section 35 of the NASD Code of Arbitration Procedure, on which the Flumes relied, is not the kind of "clear and unmistakable expression of the parties' intent to have arbitrators, not the court," determine the threshold question of arbitrability. *Flume II* at 6. Looking at the complaint, the court then decided that it fell outside the scope of the NASD arbitration agreement, both because the Flumes were no longer "customers" within the meaning of section 12(a) of the NASD Code of Arbitration Procedure, and because a dispute over the collection of a judgment was not a claim "arising in connection with" transactions in the Flumes' accounts. *Id.* at 8.

II

The initial question we must answer is who should decide the question of the arbitrability of this second round dispute between the Flumes and the brokers: the court, or the NASD arbitrators? Our starting point is the Supreme Court's decision in *First Options of Chicago, Inc. v. Kaplan*, 115 S.Ct. 1920 (1995), in which the Court made clear that "[j]ust as the arbitrability of the merits of a dispute depends upon whether the parties agreed to arbitrate that dispute, ... so the question 'who has the primary power to decide arbitrability' turns upon what the parties agreed about *that* matter." *Id.* at 1923 (emphasis in original). Because the preliminary question about the competent forum is so fundamental, however, the Court cautioned that lower courts "should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so." *Id.* at 1924 (internal quotes and brackets omitted). We must therefore review the documents constituting the arbitration agreement between the Flumes and the brokers to see if such clear and unmistakable evidence is present here.

The Flumes urge us to find this kind of unambiguous entrustment of the arbitrability issue to the arbitrators in the NASD Manual's Code of Arbitration Procedures. They rely on three sections of the Code, which taken together lead to this result in their view. First is Part I, § 1 governing "Matters Eligible for Submission" to arbitration, which reads in pertinent part:

> This Code of Arbitration Procedure is prescribed and adopted pursuant to Article VII, Section 1(a)(3) of the By-Laws of the Association for the arbitration of any dispute, claim, or controversy arising out of or in connection with the business of any member of the Association,...:

> (c) between or among members or associated persons and public customers, or others,....

See 1997 NASD Manual: Code of Arbitration Procedure (CCH) ¶ 7511 (currently designated as Rule 10101). Next is Part III, § 12(a) for "Required Submission," which specifically addresses disputes between customers and NASD members:

> Any dispute, claim, or controversy eligible for submission under the Rule 10100 Series between a customer and a member and/or associated person arising in connection with the business of such member or in connection with the activities of such associated persons shall be arbitrated under this Code, as provided by any duly executed and enforceable written agreement or upon the demand of the customer.

See 1997 NASD Manual: Code of Arbitration Procedure (CCH) ¶ 7571 (currently designated as Rule 10301(a)). Last, and most directly relevant to the arbitrability issue, is Part III, § 35 on "Interpretation of Provisions of Code and Enforcement of Arbitrator Rulings," which describes the scope of the arbitrators' authority in the following terms:

> The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code and to take appropriate action to obtain compliance with any ruling by the arbitrator(s). Such interpretations and actions to obtain compliance shall be final and binding upon the parties.

See 1997 NASD Manual: Code of Arbitration Procedure (CCH) ¶ 7581 (currently designated as Rule 10324). The Flumes' argument from these provisions is straightforward:

their "dispute" with the brokers "arose out of," or at the very least "in connection with," their securities business; the brokers themselves were either "members" or "associated persons" and the Flumes were "customers" of their firm, which meant that the dispute was arbitrable upon their demand; and section 35 is broad enough to require the arbitrators to adjudicate any particular disputes about the scope of sections 1 or 12(a).

Some circuits have accepted this general argument, bearing in mind the hospitable approach the Supreme Court has taken to arbitration in recent years. See, *e.g.*, *PaineWebber, Inc. v. Bybyk*, 81 F.3d 1193, 1202 (2d Cir.1996); *FSC Sec. Corp. v. Freel*, 14 F.3d 1310, 1312-13 (8th Cir.1994) (language of section 35 indicates that parties "clearly and unmistakably" wanted questions of arbitrability to be decided by arbitrator). This court adopted a different approach to section 35 in *Sorrells*, where the question was whether the court should conclude that section 15 of the NASD Code (now Rule 10304) imposes an absolute bar to arbitration for claims more than six years old, or if arbitrators should decide what its effect would be. See *Sorrells*, 957 F.2d at 514 n. 6, which quoted section 35 and commented that:

> we do not believe that this provision is a clear and unmistakable expression of the parties' intent to have the arbitrators, and not the court, determine which disputes the parties have agreed to submit to arbitration.

Id. Other courts have agreed with us. See *Smith Barney, Inc. v. Sarver*, 108 F.3d 92, 96-97 (6th Cir.1997); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen*, 62 F.3d 381, 384 (11th Cir.1995).

The Flumes have urged us to reconsider our conclusion in *Sorrells*, or at a minimum to distinguish limitations-of-actions

cases arising under section 15 from cases arising under other provisions of the Code. With all due respect to the courts that have taken the other position, we are not inclined to revisit *Sorrells* in the present case. First Options, which was decided after *Sorrells*, approved our requirement of a showing of "clear and unmistakable" evidence that the parties intended to have the arbitrators decide the preliminary issue of arbitrability. Section 35 says nothing about arbitrability; it instead empowers the arbitrators to "interpret and determine the applicability of all provisions under this Code." However, both interpretation and determinations about applicability are steps that take place after the threshold determination of arbitrability has occurred; or, at the very least, section 35 can reasonably be read that way. Even if it would not do violence to the language of section 35 to conclude that arbitrability may also be resolved by the arbitrators, this is not the kind of clear and unmistakable language that *First Options* requires. We therefore agree with the district court that the issue of arbitrability here was properly one for the court to resolve.

On this appeal from the district court's grant of a preliminary injunction against the Flumes' second arbitral proceeding, we can reverse only if the district court abused its discretion. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Salvano*, 999 F.2d 211, 215 (7th Cir.1993). Nevertheless, as the Supreme Court has pointed out, a district court abuses its discretion if it relies on an erroneous view of the law or on a clearly erroneous assessment of the evidence. See *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405, 110 S.Ct. 2447, 2460-61, 110 L.Ed.2d 359 (1990). The district court's interpretations of the NASD Code are reviewable de novo. See *Cogswell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 78 F.3d 474, 476 (10th Cir.1996). Since the Code sets forth the applicable agreement to arbitrate, the likelihood of the brokers' success on the merits of their action for declaratory

and injunctive relief depends entirely on the correctness of the district court's interpretation of its language.

The district court did not address the question whether the brokers were "members or associated persons" as the NASD defines those terms, perhaps because it thought the matter beyond dispute. We agree that it is clear that they were, and thus that brokers Hayne, Miller and Farni fall within the ambit of sections 1 and 12(a). The NASD by-laws define the term "member" to include "any broker or dealer admitted to membership in the [NASD]." See 1997 NASD Manual: By-Laws (CCH) ¶ 1041 (art. I, definition (m)). The terms "person associated with a member" and "associated person of a member" mean "every ... officer, director, or branch manager of any member...." See *id.* at ¶ 1042 (art. I definition (q)). Even if the brokers were not individual members of the NASD, their firm Hayne, Miller & Farni, Inc., was a member of the Association. As officers and directors of HMF, the brokers are therefore "associated persons" under definition (q), and are subject to the arbitration requirements. *Cf. Menke v. Monchecourt*, 17 F.3d 1007, 1008 (7th Cir.1994) (executive vice-president of NASD member was "associated person" for purpose of arbitration under the Code).

The magistrate judge found, however, that the Flumes could not be considered "customers" for purposes of their second arbitration proceeding because "the allegedly fraudulent transfers and conveyances ... occurred when the Flumes were not customers of HMF and when the Flumes had no relationship with plaintiffs Miller, Hayne, and Farni." *Flume II* at 8. In so holding, she relied on the decisions in *Wheat, First Sec., Inc. v. Green*, 993 F.2d 814 (11th Cir.1993), and *Gruntal & Co. v. Steinberg*, 854 F.Supp. 324 (D.N.J.1994), *aff'd*, 46 F.3d 1116 (3d Cir.1994) (table). Although these cases admittedly cast some light on the meaning of the term "customer" in the NASD Code, in our

view the magistrate judge overlooked important distinctions between the situations presented there and the case before us.

In *Wheat*, the investor-plaintiffs had held accounts with Marshall Securities, a broker-dealer firm. *Wheat*, 993 F.2d at 815. Suspecting that an agent for that firm had made material misrepresentations to them in connection with a stock purchase, they instituted arbitration proceedings against Wheat First, a successor-in-interest to certain of Marshall Securities' assets and contracts. *Id.* However, Wheat First had signed this Asset Purchase Agreement with Marshall Securities "[w]ell after" the allegedly fraudulent stock transactions had taken place; it had not been involved with any of the problematic stock purchases. *Id.* Although the investors had eventually become customers of Wheat First by virtue of the Asset Purchase Agreement, the court held they were not Wheat First's "customers" within the meaning of the NASD Code with respect to the contested transactions, because it was undisputed that they were not customers of Wheat First at the time the transactions took place. *Id.* at 820. The court therefore ruled that the determination of an investor's customer status had to be made as of the time of the events that formed the basis of their claim. *Id.* The court commented that it could not "imagine that any NASD member would have contemplated that its NASD membership alone would require it to arbitrate claims which arose while a claimant was a customer of another member merely because the claimant subsequently became its customer." *Id.*

The situation in *Gruntal* was similar. There the investors initiating the arbitration had held accounts with the Philips securities brokerage firm. *Gruntal*, 854 F.Supp. at 328-29. As in *Wheat*, Gruntal had signed an Asset Purchase Agreement by which it purchased certain specified assets from Philips. 854 F.Supp. at 329. In their arbitration claim against Gruntal, the investors alleged that two of Philips' customer representatives had failed to follow their instructions regarding

their accounts during a period prior to Gruntal's purchase of the assets. *Id.* at 330-31. Gruntal had no part in Philips' alleged misconduct; prior to the purchase, it had no association with Philips' business. *Cf. id.* at 329. Expressly following *Wheat*, the *Gruntal* court concluded that the acts at issue occurred before the investors became "customers" of the Gruntal firm and that the firm was therefore not required to arbitrate the claim. *Id.* at 339-40.

We have no quarrel with *Wheat's* holding that an investor is not a "customer" of an NASD firm for purposes of claims that arose while the claimant was a customer of a predecessor-in-interest, at least in the absence of any contractual provisions to the contrary in the asset purchase agreement. But our case presents an entirely different situation. The Flumes were customers of HMF at the time the initial fraudulent activities took place, and all of their claims against both HMF (in the initial arbitration) and its associated persons (in the second arbitration) arise out of that direct customer-broker relationship. The judgment debt they are trying to collect is one that ran from HMF to them as the firm's customers. None of the risks of remote liability that motivated the *Wheat* court exist here. Hayne, Miller, and Farni are not being asked to assume responsibility for the actions of stranger firms with whom they are linked only by an asset purchase. Instead, these persons associated with HMF will be potentially liable only to individuals who were customers of the firm while it was in operation, and only for actions that arose out of or were connected with the firm's business. *Cf. Robinson v. Shell Oil Co.*, 117 S.Ct. 843 (1997) (former employees may sue for retaliation under Title VII for actions that occurred or arose out of employment relationship).

Having concluded that Hayne, Miller, and Farni are properly "associated persons" and that the Flumes are "customers," the only remaining question is whether under

section 1 of the Code, the Flumes' dispute arose "out of" or "in connection with" a dispute between or among an NASD member (or its associated persons) and a public customer. See 1997 NASD Manual: Code of Arbitration Procedure (CCH) ¶ 7511. Section 12(a) explicitly makes claims "arising in connection with" transactions between a customer and an associated person arbitrable under the Code. See *id.* at ¶ 7571. The brokers argue (and the magistrate judge below agreed) that we should take a very narrow view of this language and find that HMF's business was limited to the buying and selling of securities. See *Flume II* at 9. Thus, since the Flumes' present claims involve alleged "fraudulent conveyance" rather than the "buying and selling of securities," the brokers reason that they fall outside the scope of the § 12(a) arbitration clause. We disagree.

As we have previously noted, once it is clear the parties have a contract that provides for arbitration of some issues between them, any doubts concerning the scope of the arbitration clause are resolved in favor of arbitration. See *Flexible Mfg. Sys. Pty., Ltd. v. Super Prods. Corp.*, 86 F.3d 96, 99 (7th Cir.1996). We have already concluded that the parties here were subject to an arbitration agreement of some scope, because they were respectively "associated persons" of an NASD member and its "customers." Moreover, the language of this particular agreement to arbitrate is quite broad, sweeping in not only claims that literally "arise out of" the business of the firm (i.e., its buying and selling activities), but also claims that have a "connection" with the firm's business. Furthermore NASD firms (and associated persons) have a duty under IM-10100(d) of the Code to honor an arbitral award that has been rendered pursuant to the procedures specified by the NASD. See 1997 NASD Manual: Code of Arbitration Procedure (Administrative Provisions) (CCH) ¶ 7511 (interpretive material). Therefore we find that an alleged failure to abide by that standard of behavior

vis-a-vis a party entitled to invoke arbitration, is as much a problem "arising out of" the firm's (or its associated persons') conduct of NASD-authorized business as the underlying "purchase and sale of securities" would be. *Cf. Royal Alliance Assocs., Inc. v. Davis*, 897 F.Supp. 783, 788-89 (S.D.N.Y.1995) (broker's unauthorized borrowing and misappropriation of client funds, and brokerage firm's failure to supervise properly, were subject to arbitration under § 12(a) as controversies "in connection with the business" of a member). See also *Tracer Research Corp. v. National Envtl. Svcs. Co.*, 42 F.3d 1292, 1295 (9th Cir.1994) (noting that language like "relating to" indicates an arbitration clause considerably broader in reach than one limited to disputes "arising out of" certain dealings).

In this court, the Flumes have argued in the alternative that their second arbitral complaint alleges direct liability on the part of the brokers in their capacity as control persons of HMF. The brokers respond that this argument was never made in so many words to the district court. Because we agree with the Flumes that their dispute is arbitrable, even as an effort to pursue the brokers for funds that should have been available to satisfy the judgment against HMF, we need not decide whether the Flumes preserved this point for appeal. (This is not a case like *Peacock v. Thomas*, 116 S.Ct. 862 (1996), in which the plaintiffs are attempting to rely on a form of ancillary jurisdiction to pursue someone who has impeded the collection of a valid judgment. The Flumes have asserted that the brokers' own obligations under the NASD Code support arbitrability and give rise to the duties they assert.) It will be up to the arbitrator to decide whether the control person argument is properly before it, given that the Flumes have already had one chance to fix blame for the earlier transactions on a responsible party.

Because the district court erred in its interpretation of the NASD Code and gave the arbitration provisions too narrow a

reading, it necessarily erred in assessing the brokers' likelihood of success on the merits for purposes of the requested preliminary injunction. This was an abuse of discretion. We conclude that the Flumes' claims are arbitrable as a matter of law under the NASD Code, and that the district court should have dismissed the brokers' action in its entirety, since it asks for nothing but relief against the arbitral proceedings. We therefore VACATE the preliminary injunction granted by the district court and REMAND with instructions that the case be dismissed so that the Flumes' arbitration proceeding may go forward.

A true copy:

Attest:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

KEVIN MILLER, WESEY C. HAYNE,
and E. CHRIS FARNI, Case No. 96-C-0029

Plaintiffs,

v.

DR. CHARLES W. FLUME,
NANCY FLUME,
CHARLES W. FLUME, D.D.S., S.C.,
DEFINED BENEFIT PLAN, and
CHARLES W. FLUME, D.D.S., S.C.

MEMORANDUM AND ORDER

Defendants.

The plaintiffs, Kevin Miller, Wesley C. Hayne, and E. Chris Farni, have filed a motion for a preliminary injunction and order to show cause enjoining the defendants, Dr. Charles W. Flume, Nancy Flume, Charles W. Flume, D.D.S., S.C., Defined Benefit Plan, and Charles W. Flume, D.D.S., S.C., a Wisconsin professional corporation, (collectively the Flumes) from pursuing any claims against them in a National Association of Securities Dealers, Inc. (NASD) arbitration action, and staying the arbitration. Based upon the stipulation of the parties, the plaintiffs' motion for a preliminary injunction was withdrawn without prejudice by Order of February 1, 1996, and subsequently renewed by the plaintiff on August 14, 1996 at a hearing conducted on October 4, 1996, the court heard oral argument on the plaintiffs' motion.

This case was assigned to this court according to the random assignment of civil cases pursuant to 28 U.S.C. § 636(b)(1)(B) and Local Rule 13.03 (E.D. Wis.). The parties have consented to United States Magistrate Judge jurisdiction. This court has subject matter jurisdiction over this matter pursuant to 28 U.S.C. § 1332 because there is complete diversity of citizenship between the plaintiff's and defendants and the amount in controversy, exclusive of interest and costs, exceeds the sum of $50,000.00. This Court also has jurisdiction pursuant to 28 U.S.C. § 1331 because this matter arises under the laws of the United States. In particular, the Federal Arbitration Act, 9 U.S.C. § 1 et seq. Venue is proper in this district pursuant to 28 U.S.C. § 1391. The plaintiffs' motion for preliminary injunction is ready for resolution and now will be addressed.

Standard for Preliminary Injunction

Under the case law of this circuit, a party is entitled to a preliminary injunction if it demonstrates that:

(1) It has no adequate remedy at law;

(2) It will suffer irreparable harm if the preliminary injunction is not issued;

(3) The irreparable harm it will suffer if the preliminary injunction is not granted outweighs the irreparable harm the defendant will suffer if the injunction is granted;

(4) It has a reasonable likelihood of prevailing on the merits; and

(5) The injunction will not harm the public interest.

See Storck USA. L.P. v. Farley Candy Co., 14 F.3d 311, 313-14 (7th Cir. 1994); Somerset House, Inc. v. Turnock, 900 F.2d 1012, 1014-15 (7th Cir. 1990); West Allis Memorial Hosp. Inc. v. Bowen, 852 F.2d 251, 253 (7th Cir. 1988); Roland Machinery Co. v. Dresser Industries, Inc., 749 F.2d 380, 386-88 (7th Cir. 1984); see also, Fed. R. Civ. P. 65. The plaintiff's threshold burden is to establish the first and second factors and to show **"some** likelihood of success on the merits." Ping v. National Educ. Ass'n, 870 F.2d 1369, 1371 (7th Cir 1989) (emphasis in original); see also, Roth v. Lutheran General Hosp., 57 F.3d 1446, 1453 (7th Cir. 1995). Once the initial burden is met, the inquiry then becomes a sliding scale analysis of the harm to the parties and the public from the grant or denial of the injunction and the actual likelihood of success on the merits. Ping, 870 F.2d at 1371; see also, Roth, 57 F.3d at 1453.

"The purpose of a preliminary injunction is to minimize the hardship to the parties pending the ultimate resolution of the lawsuit." Faheem-el v. Klincar, 841 F.2d 712, 717 (7th Cir. 1988). "The more likely the plaintiff is to win, the less heavily need the balance of harms weigh in his favor in order to get the injunction; the less likely he is to win, the more it need weigh in his favor." Ping, 870 F.2d at 1371-72 (citation omitted).

Relevant Facts

The plaintiffs are former officers or directors of Hayne, Miller & Farni, Inc. (HMF), a corporation which operated as a securities broker/dealer in Minneapolis, Minnesota. As brokers, each of the plaintiffs signed a "Form U-4, which is entitled "Uniform Application for Securities Industry Registration or Transfer." HMF was a member of the

National Association of Securities Dealers (NASD) until January 23, 1994.

The NASD, a national securities association established pursuant to 15 U.S.C. § 78O-3, is a federal self-regulatory organization. The NASD has established its own Code of Arbitration Procedure. Its arbitration rules are subject to the approval of the Securities and Exchange Commission under 15 U.S.C. § 78s(b)(1) and 17 C.F.R. § 240.19b4.

The defendants are investors who held a securities trading account with HMF from May, 1990, until approximately 1993. In June 1993, the defendants commenced a NASD arbitration action asserting various claims against an individual broker and HMF, including violations of the Employee Retirement Income Security Act (ERISA), state and federal securities fraud, common law fraud, breach of fiduciary duty and negligence, Plaintiffs Kevin Miller, Wesley C. Hayne and E. Chris Farni were not parties in the 1993 NASD action. On March 15, 1994, after five days of evidentiary hearings in Milwaukee, Wisconsin, a three person NASD arbitration panel, found HMF liable to the defendants and awarded them $150,000.00 in damages and $28,034.40 in costs.

On April 14, 1995, HMF filed an application to vacate the arbitration award in the United States District Court for the Eastern District of Wisconsin and the defendants filed a motion to confirm the award. On May 24, 1995, United States District Judge Myron L. Gordon denied HMF's motion to vacate the arbitration award, and granted the defendants' motion to confirm the award. Judgment in the amount of $178,034.40 plus interest was entered in favor of the defendants and against HMF on May 24, 1995.

Since obtaining the judgment, the defendants have not collected on the judgment. In October, 1995, the defendants initiated an NASD arbitration action (Arbitration Proceeding), naming the plaintiffs as individual respondents and seeking damages from them. The defendants' new Statement of Claim

alleges that the plaintiffs engaged in fraudulent transfers and manipulations of HMF's assets in 1993 and 1994, to avoid paying the judgment. This Statement of Claim also alleges that plaintiff Miller fraudulently "orchestrated the transfer of accounts and brokers" from HMF to another broker/dealer, GDN Securities, Ltd., also in an attempt to defraud the defendants. The NASD has indicated that the Arbitration Proceeding will take place in Milwaukee, Wisconsin. The plaintiffs deny the allegations of wrongdoing set forth in the new Statement of Claim.

Analysis

The Federal Arbitration Act (FAA), 9 U.S.C. § 1 et seq., provides for the enforcement of contracts between parties who agree to submit their claims to arbitration. The principles governing the arbitrability of disputes are well established. See United Steelworkers v. American Mfg. Co., 363 U.S. 564 (1960); United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960). These principles were reaffirmed by the United States Supreme Court in AT&T Technologies, Inc. v. Communications Workers, 475 U.S. 463 (1986).

The duty to submit a dispute to arbitration is contractual and, therefore, a party cannot be compelled to arbitrate a dispute when he has not agreed to do so. Id. at 648. The question of whether the parties have agreed to submit a particular dispute to arbitration is an issue to be determined by the courts, not the arbitrator. Id. at 649. Courts must only determine whether the grievance is arbitrable. The court is not to rule on the potential merits of the underlying grievance, even if it appears to the court to be frivolous. Id. Finally, when the contract contains an arbitration clause, there is a presumption of arbitrability unless the court determines "with

positive assurance the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage." Warrior & Gulf Navigation Co., 363 U.S. at 582-83.

In keeping with these principles, the Court of Appeals for the Seventh Circuit noted that Section 35 of the NASD Code of Arbitration Procedure provides that, "arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code which interpretation shall be final and binding upon the parties." Edward D. Jones & Co. v. Sorrells, 957 F.2d 509, 514 n. 6 (7th Cir. 1992). However, the court held that it did not believe the provision is a clear and unmistakable expression of the parties' intent to have arbitrators, not the court, determine which disputes the parties have agreed to subject to arbitration." Id. (citing AT&T, 475 U.S. at 649). Thus, under Sorrells, the question of whether the defendants' new Statement of Claim is the proper subject of arbitration proceedings before the National Association of Securities Dealers Inc., is a matter for resolution by this court.

Based on a review of the parties' submissions and upon consideration of the applicable law, this court concludes that this matter is not subject to arbitration. The Flumes' Statement of Claim that they have filed before the NASD in this matter is best summarized in paragraph 11. The paragraph states:

> This arbitration arises out of Hayne, Miller's failure to pay the arbitration award, the judgment rendered thereon, and the conduct of its principals (the respondents herein) in gutting the company and enriching themselves, thereby rendering the arbitration award uncollectible.

In seeking arbitration of this matter, the Flumes' invoke, as third-party beneficiaries, the NASD Code of Arbitration Procedure which provides in relevant part:

> Sec. 1. This Code of Arbitration Procedure is prescribed and adopted pursuant to Article VII, Section 1 (a)(3) of the By-laws of the National Association of Securities Dealers, Inc., (the Association) for the arbitration of any dispute claim or controversy arising out of or in connection with the business of any member of the Association, with the exception of disputes involving the insurance business of any member which is also an insurance company;
>
> (a) between or among members;
>
> (b) between or among members and public customers, or others;
>
> (c) between or among members or associated persons and public customers, or others;

Part I, Section 1, NASD Code of Arbitration Procedure (Briol Aff., Exh. M). (Emphasis added.)

Section 12(a) of the NASD Code of Arbitration Procedure provides that "any dispute" between customers and associated persons "shall be arbitrated . . . upon the demand of the customer." Section 12(a) reads:

> Any dispute, claim or controversy eligible for submission under Part I of this Code between a customer and a member and/or associated person arising in connection with the activities of such associated persons shall be arbitrated under this

> Code, as provided by any duly executed and enforceable written agreement or upon the demand of the customer.

Section 12(a), NASD Code of Arbitration Procedure (Briol Aff., Exh. M) (Emphasis added).

The Form U-4 signed by each plaintiff states in relevant part:

> I agree to arbitrate any dispute, claim or controversy that may arise between me and may firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the organizations with which I register as indicated in item 10 as may be amended from time to time.

This Form U-4 by its terms creates no independent duty to arbitrate. Any obligation to arbitrate arises from "the rules, constitutions, or by-laws" of any organization with which the plaintiffs are registered.

There are two critical issues in determining whether the Flumes' complaint is subject to arbitration. The first is whether the Flumes are customers within the meaning of Section 12(a) of the NASD Code of Arbitration Procedure. The second is whether a dispute is one that can be characterized as "arising in connection with the activities of such associated persons."

The meaning of the term "customer was addressed in Wheat First Securities. Inc. v. Green, 993 F.2d 814 (11th Cir. 1993) and Gruntal & Co. Inc. v. Steinberg, 854 F. Supp. 324 (D.N.J. 1994), affirmed, 46 F.3d 1116 (3rd Cir. 1994) (Table). Those decisions hold that determination of whether an individual is a "customer" must be determined as of the time of the events forming the basis of the statement of claim. Wheat, 993 F.2d at 821; Gruntal, 854 F. Supp. at 324.

The Flumes do not allege that the allegedly fraudulent conveyances and transfers arose in conjunction with the business of plaintiffs Miller, Hayne, and Farni. Rather, the allegedly fraudulent transfers and conveyances, which the Flumes set forth in their Statement of Claim for arbitration, occurred when the Flumes were not customers of HMF and when the Flumes had no relationship with plaintiffs Miller, Hayne, and Farni.

The Flumes rely upon O'Neel v. National Ass'n of Securities Dealers, Inc., 667 F.2d 804 (9th Cir. 1982) in support of their contention that they were "customers." However, O'Neel is distinguishable from the facts of this case. That case involved a NASD member who attempted to avoid his arbitration responsibilities by resigning from the NASD. In that case, the court rejected the member's contention holding that:

> It would seem strange indeed that with such a significant integrated method of dispute settlement one party could frustrate the purpose of the Exchange rules and the federal policy favoring arbitration by the mere expediency of resignation from the Exchange.

667 F.2d at 807 (citing Muh v. Newburger, Loeb & Co. Inc., 540 F.2d 970, 973 [9th Cir. 1976]).

Furthermore, the dispute between the Flumes and the plaintiffs in this action is outside the parameters of subject matters which are covered by the NASD Code of Arbitration. Under the code, a dispute must be "in connection with the business of such member or in connection with the activities of such associated person." In essence, the Flumes' claim is that the plaintiffs fraudulently conveyed and manipulated HMF's assets to avoid paying them as judgment creditors. The plaintiffs were not parties to the original arbitration dispute

nor does the current dispute arise "in connection with the business of such member or in connection with the activities of such associated person."

The various definitions set forth in the by-laws of Article I of the NASD Manual make it is clear that the "business" of such a member or the "activities" of such associated persons are the buying and selling of securities. The arbitration claim which is the subject of this action does not involve issues concerning the buying and selling of securities. Those claims were the subject of the initial arbitration upon which the Flumes ultimately obtained their judgment on May 24, 1995. On that date, United States District Judge Myron L. Gordon of this district denied HMF's motion to vacate the arbitration award and granted the defendants' motion to confirm the arbitration award.

Here, the Flumes have initiated a second arbitration proceeding alleging fraudulent conveyances of assets of HMF by the plaintiffs. These are not claims arising out of the transactions in the Flumes' accounts and are not in connection with the business of HMF.

The facts of this case are analogous to those of Armada Coal Exports, Inc. v. Interbulk Limited, 726 F.2d 1566 (11th Cir.1984). In that case, a coal company, which had chartered a vessel, brought an action against the vessel owner seeking damages for "wrongful and unlawful attachment" of the company's coal and for conversion of the company's letter of credit. The vessel owner moved to stay the company's tort suit pending arbitration, relying upon an arbitration clause in the vessel charter agreement. The vessel owner had claims against the company caused by delays in obtaining the company's coal for loading in the vessel. This caused the vessel owner to be charged extra dockage fees. It was those claims that led the vessel owner to attach the company's coal.

In seeking arbitration, the vessel owner relied upon the arbitration agreement between the parties which provided for

arbitration of "any dispute arising during the execution of the charter party." The court held that such arbitration agreement would include claims of the vessel owner for the extra dockage fees, but did not encompass the company's tort action against the vessel owner for damages for "wrongful and unlawful attachment" of the company's coal and for conversion of the company's letter of credit. The court held that the tort claims were procedurally wholly apart from the agreement to charter a vessel, were not foreseen by the parties as a matter intended for the arbitration forum, and would be better handled by the courts. Armada, 726 F.2d at 1568.

In the instant case, the Flumes' claims only arise because of, and as a result of the judgment they obtained in their previous arbitration. The claims in the prior arbitration clearly arose out of the business of HMF. The nexus between these two claims are not sufficient to enforce arbitration for the claimed fraudulent conveyances by the plaintiffs who were not even parties in the original arbitration. Id; see also, Texaco Inc. v. American Trading Transportation Co., 644 F.2d 1152 (5th Cir. 1981).

The Flumes' assertion that "but for" the wrongful conduct of HMF with regard to the sale of unsuitable securities, they would not be seeking redress from plaintiffs Miller, Hayne, and Farni is overly simplistic. See Tracer Research v. Nat. Environ. Services. Co., 42 F.3d 1292, 1295 (9th Cir. 1994). The Flumes' claim for arbitration in this case is simply too far removed from any securities transactions by persons associated with plaintiffs Miller, Hayne, and Farni. The Flumes' claim against the plaintiffs for fraudulent conveyance falls outside the scope of disputes which are arbitrable under the NASD Code of Arbitration. This court's conclusion is also consistent with the construction given to the arbitration provisions of the New York Stock Exchange constitution and rules governing member/non-member controversies which requires that controversies subject to arbitration arise out of

"exchange related business." See Spear Leeds & Kellogg v. Central Life Assur. Co., 85 F.3d 21, 29-30 (2nd Cir. 1996), cert. denied, ___ U.S.___, 65 U.S.L.W. 3432 (December 16, 1996); Paine, Webber, Jackson & Curtis v. Chase Manhattan, 728 F.2d 577, 580 (2nd cir. 1994).

Accordingly, the plaintiffs have shown a likelihood of success on the merit of their claim that the matters set forth in the Flumes' statement of claim for arbitration are not arbitrable. They have also established that they would suffer irreparable harm and have no adequate remedy at law if an injunction were not issued. Accordingly, this court will grant the plaintiffs' motion for preliminary injunction.

ORDER

NOW, THEREFORE, IT IS ORDERED that the plaintiffs' motion for a preliminary injunction and hereby is **GRANTED**.

This case is set for a telephone status conference on January 18,1997, at 1:30 p.m. to discuss further proceedings in this matter.

Dated at Milwaukee, Wisconsin this 26th day of December.

BY THE COURT:

/s/

PATRICIA J. GORENCE
United States Magistrate Judge

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

KEVIN MILLER, WESEY C. HAYNE, and
E. CHRIS FARNI, Case No. 96-C-0029

Plaintiffs,

v.

DR. CHARLES W. FLUME, NANCY FLUME,
CHARLES W. FLUME, D.D.S., S.C., **AMENDED**
DEFINED BENEFIT PLAN, and **ORDER**
CHARLES W. FLUME, D.D.S., S.C.

Defendants.

On December 26, 1996, this court issued a *Memorandum and Order* in the above-captioned action. It has come to the court's attention that the order contained a typographical error.

NOW, THEREFORE, IT IS ORDERED that page 12 of the court's *Memorandum and Order* is amended as follows:

> This case is set for a telephone status conference on **January 14**, 1997, at 1:30 p.m. to discuss further proceedings in this matter.

Dated at Milwaukee, Wisconsin, this 27th day of December, 1996.

BY THE COURT:

/s/
PATRICIA J. GORENCE
United States Magistrate Judge

NATIONAL ASSOCIATION OF
SECURITIES DEALERS, INC.
ARBITRATION

In the Matter of the NASD File No. _____

Arbitration Between:

Dr. Charles W. Flume; Nancy Flume;
Charles W. Flume, D.D.S., S.C.;
Defined Benefit Plan; and
Charles W. Flume, D.D.S., S.C.,
a Wisconsin professional
corporation,

Claimants,

and STATEMENT OF CLAIM

Kevin Miller, Wesley C. Hayne and
E. Chris Farni,

Respondents.

The Parties

1. The claimants are Dr. Charles W. Flume, his wife Nancy Flume, the Charles W. Flume, D.D.S., S.C., Defined Benefit Plan, and Dr. Flume's professional-corporation, Charles W. Flume, D.D.S., S.C. (claimants are collectively

referred to as "the Flumes"). The Flumes are residents of LaCrosse, Wisconsin.

2. The Respondents are Kevin Miller, Wesley C. Hayne, and E. Chris Farni. The Respondents are former principals and control persons of the now defunct broker dealer known as Hayne, Miller & Farni, Inc., thereafter sometimes referred to as "Hayne, Miller").

The Prior Arbitration.

3. In June 1993, the Flumes commenced an NASD arbitration against Hayne, Miller & Farni, Inc. and its former broker, James D. Peterson.

4. An arbitration trial was held in Milwaukee, Wisconsin, on January 12-13, 1994 and February 9-11, 1994. Mr. Peterson filed for bankruptcy shortly before the arbitration and all proceedings against him were stayed.

5. The arbitration panel issued a $178,034.40 award against Hayne, Miller & Farni, Inc. and in favor of the Flumes on March 15, 1994. A copy of the arbitrators' award is attached as Exhibit 1. The arbitrators also issued a Report of Arbitration, which made a disciplinary referral to the NASD's District Business Conduct Committee. The Report of Arbitrators is included as part of Exhibit 1.

6. Shortly after the arbitration award issued, Hayne, Miller & Farni, Inc. changed its name to Hayne Miller Financial, Inc. The name change was filed with the New York Department of State on March 21, 1994, one week after the arbitrators issued their award.

7. In April 1994, Hayne, Miller filed an application to vacate the arbitration award with the United States District for the Eastern District of Wisconsin. Hayne, Miller's appeal to the federal district court was in bad faith, frivolous and taken solely to delay the entry of a Judgment against it. The appeal was part of a plan by the firm's principals (the respondents

here) to enrich themselves at the expense of public customers who were defrauded by Hayne, Miller.

8. The Flumes filed a cross-motion in the Wisconsin federal court. The Flumes asked the Court to confirm the award and to deny Hayne, Miller's motion to vacate. On April 27, 1995, the Magistrate Judge for the Eastern District of Wisconsin, the Honorable Aaron Goodstein, recommended confirmation of the award. (Exhibit 2 hereto). Once again, as a part of its stall tactics, Hayne, Miller, acting pursuant to instruction from the respondents, filed another appeal.

9. On May 24, 1994, the United States District Court for the Eastern District of Wisconsin, the Honorable Myron L. Gordon, granted the Flumes' motion to confirm the arbitration award. The Court also denied Hayne, Miller's motion to vacate the award. (Exhibit 3 hereto). A judgment in the amount of $178,034.40, plus interest at the rate of 5% from the date of the award, was entered in favor of the Flumes and against Hayne, Miller. Id. The federal clerk of court also taxed costs against Hayne, Miller in the additional amount of $67.20.

10. No part of the arbitration award has been paid.

11. This arbitration arises out of Hayne, Miller's failure to pay the arbitration award, the judgment rendered thereon, and the conduct of its principals (the respondents herein) in gutting the company and enriching themselves, thereby rendering the arbitration award uncollectible.

Hayne, Miller's Principals Loot The Company In An Attempt To Avoid Its Responsibilities To Public Customers Who Were The Victims Of Securities Fraud.

12. While the appeal was pending in federal court, Hayne, Miller ceased operating as a broker-dealer. We have been advised the company no longer has sufficient assets to satisfy the award.

13. Hayne, Miller's Form X-17A-S, filed with the State of Minnesota, reveals that the principals of Hayne, Miller gutted the company in order to avoid paying its obligations to creditors, including the victims of securities fraud, such as the Flumes.

14. For example, in 1993, Hayne, Miller transferred securities with a market value of over $1,175,000 to Hayne, Miller's parent company, HMF Holdings, Inc. Hayne, Miller's X-17A-5, filed with the State of Minnesota on March 10, 1994, states:

> In 1993, the Company [Hayne, Miller & Farni, Inc.] transferred investment securities with an approximate market value of $1,175,000 at the date of transfer to its parent, HMP Holdings, Inc. and recorded the transaction as a reduction of additional paid-in capital.

See Exhibit 4 hereto (excerpt for Hayne, Miller's form X-17A-5). The $1,175,000 in securities siphoned out of Hayne, Miller to the parent company is in addition to at least $450,000 in "management fees that Hayne, Miller also paid to the parent company in 1993. Id.

15. In February 1994, E. Chris Farni resigned as Chief Executive Officer of Hayne, Miller. In August 1994, Wesley C. Hayne resigned as President and Chief Executive Officer of Hayne, Miller.

16. Hayne, Miller ceased doing business in November 1994, after Hayne, Miller's principals had looted the company by extracting at least $1,625,000 from the company (i.e. $1,175,000 in securities and $450,000 in management fees).

17. The conduct of the principals of Hayne, Miller in orchestrating the transfer of at least $1,625,000 in assets from Hayne, Miller to the parent company (presumably owned by the principals), while leaving public customers such as the

Flumes holding an empty bag, constitutes a violation of Article III, Section 1 of the NASD Rules of Fair Practice. See also Stephen Inc. Securities, Inc. v. SEC, 27 F.3d 3Ag (8th Cir. 1994).

18. We do not yet know the full scope of the fraudulent transfer. Accordingly our claim is not to be limited to the $1,625,000 we already know was taken from Hayne, Miller.

Kevin Miller Further Loots The Company.

19. When Hayne, Miller ceased operating as a broker dealer in November 1994, respondent Kevin Miller left Hayne, Miller and became associated with a brokerage house then known as GDN Securities. At that time, valuable assets of Hayne, Miller, including its customer accounts and retail brokerage force, were transferred to GDN Securities. GDN Securities recently changed its name to Miller Financial Group. Respondent Kevin Miller now controls Miller Financial Group, and continues to reap the profits and benefits from the assets (i.e., customer accounts and brokerage workforce) which were transferred to GDN Securities (now known as Miller Financial Group).

20. The transfer of the customer accounts and broker workforce by Mr. Miller is a further part of the fraudulent scheme for which respondent Miller is personally liable. We will determine in discovery whether other assets of Hayne, Miller such as furniture and equipment, pending deals, etc., were also transferred from Hayne, Miller to GDN in the furtherance of the calculated attempt to prevent the victims of securities fraud, the Flumes, from collecting on their arbitration award.

21. This panel should now take action against the former principals of Hayne, Miller, i.e., Kevin Miller, Wesley C. Hayne and E. Chris Farni. The Respondents should be required to disgorge all funds and securities (including the

proceeds thereof) drained from Hayne, Miller. The required disgorgement to the Flumes should be at least sufficient to satisfy the $178,034.40 arbitration award, along with the interest that continues to accrue on that unpaid award.

22. Respondents Kevin Miller, Wesley C, Hayne and E. Chris Farni were control persons of Hayne, Miller. During their tenure as control persons, numerous acts of securities fraud were committed by Hayne, Miller against public customers, including, but not limited to, the Flumes. While in control of Hayne, Miller & Farni, Inc., the individual Respondents not only participated in fraudulent conduct, but also failed to discharge their legal duty to properly supervise the registered representatives employed by Hayne, Miller & Farni, Inc., including the Flumes' broker James D. Peterson.

23. Kevin Miller, Wesley C. Hayne and E. Chris Farni are personally liable to the Flumes for the full amount of the arbitration award, $178,034.40, plus interest at the rate of 5% from the date of the award (March 15, 1994), plus the costs and attorneys' fees incurred in prosecuting this arbitration. The arbitrators should also award multiple damages against the individual Respondents under the Minnesota Punitive Damage Statute, and other laws designed to protect the public, deter improper conduct and to provide full relief. The damages sought by the Flumes from the individual Respondents are as follow:

Item	Amount
Amount awarded by Arbitrators and confirmed by the court	$178,034.40
Interest awarded by the court	12,560.22

- 5% simple from the date of the award, March 15, 1994 $8,901.72 per year - $24.39 per day) - computed through August 15, 1994	
Costs taxed by clerk of court	67.20
	$190,661.82
Attorneys' fees per Minn. Stat. Sec. 80A.23	$ 30,000.00
Subtotal:	$220,661.82
Punitive damages per Minn. Stat. Sec. 549.20	$220,661.82
Total Award:	$441,323.64

24. The Flumes are also entitled to the costs of prosecuting this arbitration, including the filing fee of $950. The Flumes will also update their damage calculations to include additional interest on the prior arbitration award, which continues to accrue at the rate of $24.39 per day.

25. The individual Respondents are liable to the Flumes under the following rules and laws, among others:

1. The laws prohibiting fraudulent conveyances and transfers, including the Minnesota Uniform Fraudulent Transfer Act, Minn. Stat. § 513.41 - 51.

2. The Doctrine of Respondent superior.

3. Common Law Fraud.

4. Common Law principles of Unjust Enrichment.

5. The NASD Rules of Fair Practice, including Article III, Section 1, of the Rules of Fair Practice, which requires NASD members and associated persons to achieve high standards of commercial honor and just and equitable principles of trade in their dealings with public customers.

6. The state and federal securities laws, including Minn. Stat. § 80A.23.

7. The Minnesota Punitive Damage Statute, Minn. Stat, Sec. 549 20.

WHEREFORE, claimants Charles W. Flume, Nancy Flume, the Charles W. Flume, D.D.S., S.C., Defined Benefit Plan, and Charles W. Flume, D.D.S., S.C., respectfully request that the arbitration panel issue an award in their favor and against Kevin Miller, Wesley C. Hayne, and E. Chris Farni, jointly and severally, as follows:

1. For an award of-actual out-of-pocket damages in the amount of $178,034.40, plus interest at the rate of 5% simple from the date of the original award, March 15, 1994.

2. For a further award of costs taxed by the clerk of court in the amount of $67.20.

3. For an award of claimant's attorneys' fees in the amount of $30,000.00 or such other amount as the arbitrators deem reasonable, under the Minnesota Securities Law, Minn. Stat. § 80A.23, and under general equitable principles.

4. For further award of $220,661.82, under the general punitive damage statute, Minn. Stat. § 549.20.

5. For a total award, exclusive of costs, of $441,323.64.

6. For a further award of all of claimant's costs, disbursements and expenses incurred in pursuing this arbitration.

7. For such other relief as the arbitrators shall deem just and equitable in the premises.

Dated: 10-6-95 Briol & Wilmes

By /s/ Gregory L. Wilmes

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